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UNCLAS SECTION 01 OF 03 ANKARA 001447

SIPDIS

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TREASURY FOR OASIA - MILLS AND LEICHTER
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E.O. 12958: N/A
TAGS: ECON EFIN PREL TU
SUBJECT: TEKEL PRIVATIZATION: DOWNSIZING A MONSTER OR JUST MOVING IT TO THE PRIVATE SECTOR?

REF: 02 ANKARA 3538

Sensitive but unclassified. Not for internet distribution.

¶1. (SBU) Summary: The AK government has highlighted its commitment to accelerate privatization, and to realize $4 billion in privatization revenue in 2003. The feature privatization in the first half of 2003 is TEKEL. This cable describes Turkey's 70-year old tobacco and spirits giant TEKEL, its plans for privatization, and the conflict between this privatization and the goal of market liberalization. A newly formed tobacco and alcohol regulations board, which is supposed to liberalize the markets, consists primarily of former TEKEL employees who have a vested interest in protecting TEKEL, including in its privatized form, from competition. Parliament helps protect TEKEL by maintaining high taxes and trade barriers on competitors. The GOT justifies these measures by saying they are needed to make the sale of TEKEL attractive, to ease the pain of job layoffs in TEKEL, and to regulate alcohol sales in a Muslim country. The reality post-privatization is likely to be GOT exercising statist control over these industries, with little to no market liberalization gains. End Summary.

A SNAPSHOT OF THE MONSTER

¶2. (SBU) TEKEL is a classic, inefficient parastatal. First founded in 1932 to carry out "monopoly services" concerning tobacco, alcoholic drinks, salt, gun powder and explosives, it has dominated Turkey's market for tobacco and spirits sales for 70 years. TEKEL has 33,000 employees and direct subcontractors, and supports hundreds of thousands of tobacco farmers who sell tobacco leaf to the company. TEKEL,s market share in Turkey is 69% for cigarettes, 96% in alcoholic spirits (TEKEL retains a monopoly on importing spirits), and 31% in wine. With more than 1,300 workers in its salt industry establishment, TEKEL has dominated this industry as well. In 2001, TEKEL,s total assets were valued at approximately $2.6 billion, its share of Gross National Product was approximately 2%, and its contribution to total tax revenues collected by the Treasury was about 4.9%, per TEKEL.

¶3. (SBU) In the tobacco sector, which has allowed foreign competition since 1991, Philip Morris is currently producing 41% as many cigarettes as TEKEL despite only having 3% of TEKEL's cigarette workforce. (TEKEL is currently producing 66,000 tons of cigarettes per year compared to Philip Morris, 27,000 tons per year. TEKEL,s cigarette establishment employs 7,375 employees in six factories, and another 15,628 in its leaf tobacco processing operations. Philip Morris, meanwhile, has just one factory in Izmir employing 650 people. The rest of its operations are contracted.) Sakir Karpat, Philip Morris Government Relations Manager in Turkey, said that once TEKEL is privatized, he envisions its tobacco operation could be run with only 2,000 employees.

¶4. (SBU) TEKEL,s excessive weight is not entirely the fault of its management. Until early 2002, when Parliament enacted legislation officially transferring it to the Privatization Administration (PA), TEKEL was required to buy tobacco stocks from farmers across the country, often taking in stock that it did not need. TEKEL continues to buy unneeded tobacco, even without formal instructions. This includes a substantial amount of tobacco from Southeast Turkey, which is considered inferior to tobacco grown along the Aegean coast,

near Izmir. As a result, TEKEL currently has 500,000 tons of tobacco in warehouse storage, nearly five times its annual level of production.

Current Status of Privatization

¶5. (SBU) Ayhan Sarisu, the PA official who oversees the TEKEL privatization, told us the PA plans to advertise the primary tender for the sale of TEKEL by June 2003, and hopes to complete the sale and collect revenue by the end of this year. The PA has to first await final approval of the TEKEL privatization plan by the GOT's Higher Privatization Council, expected shortly, which is a prior condition for completion of the IMF 4th Review.

¶6. (SBU) Sarisu has declared that 100% of TEKEL will be sold in two primary block sales: one for the tobacco operations and the other for alcohol. The tobacco sale will be further split into two parts: the six cigarette factories will encompass the June 2003 tender while TEKEL's two large tobacco leaf processing plants, in Izmir and Diyarbakir, and its excess stocks of tobacco will be tendered later this year (Sarisu stresses that all sales will be finalized by the end of the year). One of Sarisu's top goals is reducing the baggage TEKEL currently has to prepare it for sale. He plans to resolve TL 600 trillion (approximately $400 million) worth of unpaid tax liens by transferring some of TEKEL,s unused real estate assets to the Treasury Undersecretariat.

¶7. (SBU) Sarisu realizes that many portions of the TEKEL enterprise are unwanted, and worries that any purchaser will immediately downsize certain warehouses and distribution centers with little regard to the social effects. Thus, he wants to sell TEKEL,s distilleries and six tobacco plants, then use the PA authority to close down warehouses and distribution centers using a portion of the proceeds from the TEKEL sale as severance packages for the displaced workers. This would supplement the 2001 World Bank-GOT funded &Privatization Social Support Project,8 which provides $250 million in severance packages to state employees who lost their jobs. The World Bank funds 70% of this program while the GOT funds the remaining 30%.

¶8. (SBU) While Sarisu wants to get rid of TEKEL,s dead weight, some industry officials claim that he is not going far enough. Karpat, of Philip Morris, said that if all six factories are sold in one block sale, it will severely limit the amount of bidders with deep enough pockets to afford a bid that might be in excess of $1 billion. (Karpat said that only Philip Morris and British American Tobacco would be able to afford all six factories.) More worrisome for Karpat is the reaction of the Competition Authority (CA). If Philip Morris were to purchase TEKEL,s six tobacco factories and, thus, acquire TEKEL,s popular brand names, its market share would increase from 25% to approximately 85%, possibly disqualifying it from purchasing TEKEL. Sarisu insists this is not the case. He said that the solution for Philip Morris is to form a consortium with other tobacco companies so that it can delegate parts of the tobacco operations after the purchase. The CA, which was expected to have three of its 11 board members replaced by the new AK government on March 5, is expected to rule on the TEKEL tender shortly.

Privatization's Conflict
with Market Liberalization

¶9. (SBU) A separate but related issue is liberalization of the alcohol and tobacco markets. (As a part of the 1996 Customs Union between Turkey and the European Union, various trade liberalization measures were to be taken, including elimination of TEKEL's monopoly status for alcoholic beverage imports, by 1999.) Accompanying the legislation that added TEKEL into the PA in February 2002 were provisions designed to protect TEKEL from competition during the tenders process so that the GOT can command a higher price. GOT officials are not hiding the motive. &We did it to protect TEKEL to make it more attractive" for potential bidders, the PA's Sarisu said.

¶10. (SBU) On the alcohol/spirits side, the key regulatory barrier states that, in 2002, only companies whose annual production, imports or sales in Turkey exceed 1 million liters will be permitted to import, price, and distribute their products directly. All other companies must continue to channel their sales, with the exception of whisky and champagne, through TEKEL. This high threshold severely

curtailed the ability of foreign exporters to enter the market independent of TEKEL control last year, as very few companies could achieve sales in excess of one million liters. TEKEL itself only imports 400,000 liters of spirits annually. According to the decree, the 1 million liter minimum was reduced to 900,000 liters in 2003, and will be phased out in increments until 2007, when the Board of Ministers will be authorized to eliminate this sales minimum. In addition, a number of onerous labeling and certification requirements have been implemented in the past year.

¶11. (SBU) Similar provisions exist on the tobacco side. In 2003, the new legislation requires companies wanting a production license to build factories with an annual production capacity of at least 2 million cigarettes, which translates into approximately 2,000 tons; this once again severely limits entry into the market. The threshold is reduced to 1 billion, 800 million cigarettes in 2004, and is again phased out in increments until 2007. In addition, a number of new importation taxes will make it more difficult for existing tobacco producers such as Philip Morris and for any potential newcomers.

¶12. (SBU) TEKEL,s role as a government regulator has been transferred to a new alcohol and beverages regulation board. Staffing for this board has just begun, with nearly all its personnel former TEKEL employees. The committee will eventually be comprised of 240 officials, and fall under a 7-person Board of Ministers comprised of political appointees selected by various GOT ministries. The chairman of this board, Niyazi Adali, is the former Deputy Director General of TEKEL.

¶13. (SBU) Officials of the new regulatory body dismiss conflict of interest allegations, claiming that TEKEL employees have more experience in the industry than anyone else in Turkey. They say that the harsh restrictions at present are a benevolent way of carefully opening up markets that have social implications. Board official Fugen Basmaci, a former TEKEL employee of 22 years, commented that TEKEL had &a nice history8 since the 1930,s with no counterfeiting or health problems. She said the board is trying to liberalize the market, but that &after 70 years, opening the doors is difficult. We are trying to protect the market from cheap, unglorified products.8 She added that, in a Muslim country, the board needs to be sensitive to how alcohol is distributed.

¶14. (SBU) Embassy has received complaints about TEKEL's privatization from U.S. companies in both the distilled spirits and tobacco businesses. In response, Embassy officials have raised the issue of protective trade measures with the PA and the General Directorate of Tobacco and Alcohol. We have impressed upon the GOT that the current laws on import of distilled spirits is inconsistent with free market principles, and have requested that they consider modifying this law to allow greater transparency and competition.

Comment

¶15. (SBU) Offering TEKEL for privatization as planned this June will be a good indication of the GOT's reform commitment, and it will attract serious foreign investor interest. However, the various justifications given for extending the company's monopoly privileges until 2007, a lifetime in Turkey, all ring hollow. They rob the privatization of some of the efficiency benefits which would otherwise flow. And as the experience of privatized steel plant Kardemir shows (see reftel), industry here, whether privatized or not, remains tied to the state, and often acts as an instrument of state policy.
PEARSON